SURREBUTTAL TESTIMONY AND EXHIBIT OF DAVID C. PARCELL ON BEHALF OF THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF DOCKET NO. 2018-318-E IN RE: APPLICATION OF DUKE ENERGY PROGRESS, LLC FOR ADJUSTMENTS IN ELECTRIC RATE SCHEDULES AND TARIFFS AND REQUEST FOR AN ACCOUNTING ORDER

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is David C. Parcell. I am a Principal and Senior Economist of Technical Associates, Inc. My business address is Suite 130, 1503 Santa Rosa Rd., Richmond, Virginia 23229.

Q. ARE YOU THE SAME DAVID C. PARCELL WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING ON BEHALF OF THE OFFICE OF REGULATORY STAFF ("ORS")?

A. Yes, I am. I pre-filed Direct Testimony and two (2) exhibits with the Public Service Commission of South Carolina ("Commission") on March 4, 2019.

Q. WHAT IS THE PURPOSE OF YOUR PRESENT TESTIMONY?

A. My present testimony is prepared to respond to the Rebuttal Testimonies of Duke Energy Progress, LLC ("DEP" or "Company") witnesses Robert B. Hevert and John L. Sullivan, III.

Q. HOW HAVE YOU ORGANIZED YOUR RESPONSES TO MR. HEVERT'S AND MR. SULLIVAN'S REBUTTAL TESTIMONIES CONCERNING THE COMMON EQUITY COST RATE?

A. Mr. Hevert's Rebuttal Testimony, as it is directed toward my Direct Testimony, addresses the concepts of capital market conditions, DEP and electric utility risks, and various cost of equity models – DCF, CAPM, and CE. Accordingly, my Surrebuttal Testimony addresses each of these concepts in turn. Mr. Sullivan's Rebuttal Testimony states that my use of DEP's actual December 31, 2017 cost of long-term debt is inconsistent with my proposal in Duke Energy Carolinas, LLC ("DEC"). I also respond to Mr. Sullivan's claim. Finally, I respond to the respective Rebuttal Testimonies of Mr. Hevert and Mr. Sullivan that make claims about the financial and rating agency impacts of ORS' rate proposals on DEP.

Q. HAVE YOU PREPARED AN EXHIBIT IN SUPPORT OF YOUR TESTIMONY?

A. Yes, I have prepared one (1) exhibit, identified as Surrebuttal Exhibit DCP-1. This exhibit is comprised of two (2) schedules.

Q. DO YOU HAVE ANY GENERAL COMMENTS CONCERNING MR. HEVERT'S REBUTTAL TESTIMONY?

A. Yes, I do. Mr. Hevert's Rebuttal Testimony, like his Direct Testimony, is biased and focuses only on aspects of cost of capital that favor the Company. In addition, as I note elsewhere, he takes inconsistent positions on issues as he perceives they favor his position. Finally, I point out several instances in which he mis-represents the positions taken in my Direct Testimony.

Q. MR. HEVERT HAS DESCRIBED YOUR RETURN ON EQUITY RECOMMENDATION AS "UNDULY LOW" AND "FAR BELOW THOSE [ROEs] AUTHORIZED FOR OTHER UTILITIES NATIONALLY." WHAT IS YOUR RESPONSE TO THESE ASSERTIONS?

A. Mr. Hevert has described my return on equity recommendation as "unduly low" (page 3, lines 17-18 and page 4, lines 1-2 of his Rebuttal Testimony) and stated that my recommendation is "far below those authorized for other utilities nationally" (page 7, lines 5-7). However, the reality of the situation is that Mr. Hevert's recommendation is unduly high and is far above those authorized for other utilities nationally. This is demonstrated by his own Chart 2 on page 13 of his Rebuttal Testimony, which indicates that for the period he shows, only *one* authorized return on equity is above 10.5 percent and *over 25* authorized returns on equity are 9.5 percent or less. Clearly this demonstrates that his claim about my testimony is incorrect and the reverse claim applies to his recommendation.

It is also noteworthy that Mr. Hevert's Chart 2, which purportedly shows how recent commission ROE awards relate to our respective recommendations in this proceeding, shows his ROE range for comparative purposes and only shows my midpoint ROE, in an effort to make his recommendation appear more favorable. As I noted previously, Mr. Hevert's Rebuttal Testimony mis-represents my Direct Testimony and focuses only on those aspects that he perceives favor the Company position.

Q. DO ANY OF MR. HEVERT'S POSITIONS TAKEN IN HIS REBUTTAL TESTIMONY CAUSE YOU TO CHANGE YOUR DIRECT TESTIMONY AND RECOMMENDATIONS?

A. No, they do not.

II. CAPITAL MARKET CONDITIONS

Q. ON PAGES 25-27 OF HIS REBUTTAL TESTIMONY, MR. HEVERT DISAGREES WITH YOUR CONCLUSION THAT CAPITAL MARKET CONDITIONS HAVE RESULTED IN A DECLINE IN DEP'S CAPITAL COSTS IN RECENT YEARS. WHAT IS YOUR RESPONSE TO THIS?

A. It is obvious that capital costs have been declining since the Great Recession, as I indicated on pages 14-15 of my Direct Testimony. This is true for DEP both from the standpoint of the Company's cost of debt and cost of equity.

Turning first to DEP's cost of debt, there is no dispute that the *actual* cost of DEP's long-term debt has declined from 4.41 percent in 2013[1] to 4.16 percent currently, as shown below:

Year	Wgt. Avg. Cost of Debt
2013	4.41%
2014	3.91%
2015	3.94%
2016	4.17%
2017	4.06%
2018	4.16%

(Source: 2013-2018 debt costs from response to ORS Rates Request 32-1.)

As this indicates, DEP's embedded cost of long-term debt has declined by 25 basis points since 2013.

In addition, the relative *current* cost of Aa-rated utility debt (*i.e.*, DEP's ratings) has also declined, as shown on my Exhibit DCP-2, Schedule 2, page 2:

[1] Response to DEP ORS Rates Request 32-1.

Year	Yield
2013	4.24%
2014	4.19%
2015	4.00%
2016	3.73%
2017	3.82%
2018	4.09%
2019 (February)	4.05%

Contrary to Mr. Hevert's claims, it is indisputable that the costs of long-term debt, both for DEP's *actual* cost and for Aa-rated utilities' *current* cost, have declined.

In addition, contrary to Mr. Hevert's assertions on pages 12-13, it is evident that U.S. regulatory commissions have recognized the decline in capital costs by reducing the authorized returns on equity ("ROE") for electric utilities:[2]

Year	Avg. ROE	Median ROE
2008	10.37%	10.30%
2009	10.52%	10.50%
2010	10.29%	10.26%
2011	10.19%	10.14%
2012	10.02%	10.00%
2013	9.82%	9.82%
2014	9.76%	9.75%
2015	9.60%	9.53%
2016	9.60%	9.60%
2017	9.68%	9.60%
2018	9.58%	9.50%

It is inconceivable how Mr. Hevert cannot acknowledge the decline in authorized ROEs since the Great Recession.

Even DEP's current filing reflects a reduction in the Company's perceived cost of equity. This is demonstrated by the Company's requested capital costs in its applications for the last rate proceeding (*i.e.*, Docket No. 2016-227-E in 2016) and the current case, as shown below:

[2] As shown on page 15 of my Direct Testimony.

Cost of Capital Issue	Docket No. 2016-227-E	Current Case
Common Equity Ratio	53.00%	53.00%
Cost of Long-term Debt	3.94%	4.06%
Return on Equity	10.75%	10.50%

It is thus apparent that DEP considers its cost of equity has *declined* from 10.75 percent in 2016 to 10.50 percent currently.

In addition, it is noteworthy that Mr. Hevert's proposed 10.75 percent ROE has not been adopted by any U.S. state regulatory commission since 2011,[3] a period of eight years.[4] Mr. Hevert is therefore asking this Commission to allow DEP to charge rates to South Carolina ratepayers that incorporate the highest ROE authorized in the continental U.S. over the past eight years.

Finally, as I indicated in my Direct Testimony on page 16 and Schedule 3 of Exhibit DCP-2, recently-authorized ROE's for electric utilities continue to incorporate reduced ROE levels in comparison to previously-authorized ROEs.

III. RELATIVE RISKS OF DEP

Q. MR. HEVERT MAINTAINS, ON PAGES 27-35 OF HIS REBUTTAL TESTIMONY, THAT DEP IS NOT LESS RISKY THAN ELECTRIC UTILITIES IN GENERAL. WHAT IS YOUR RESPONSE TO HIS ASSERTIONS?

A. Mr. Hevert's contentions are categorically refuted by both rating agencies and security investment services. As I indicated in my Direct Testimony on pages 17-18 and Schedule 7 of Exhibit DCP-2, DEP has been and remains higher-rated, and thus less risky, than electric utilities in general, as well as those utilities in Mr. Hevert's proxy group. DEP's higher security ratings are reflective of less risk for the Company than for the proxy

[3] Except for a single settled case in Alaska for a remote electric utility. In this proceeding, the Alaska utility requested a ROE of 13.80 percent, which is well above the 10.5 percent requested by DEP in the current case.
[4] Exhibit No. RBH-6.

companies. One prominent reason for this is the Company's use of multiple regulatory mechanisms, including various accounting deferrals.

Q. DOES MR. HEVERT'S 10.75 PERCENT ROE RECOMMENDATION IMPLICITLY ASSUME THAT DEP IS MORE RISKY THAN OTHER ELECTRIC UTILITIES?

A. Yes, it does. By recommending a ROE that is more than 100 basis points higher than recent ROE awards (*i.e.*, 10.75 percent versus 9.5 percent to 9.6 percent over the past three years) awarded other electric utilities, Mr. Hevert presumes that DEP is more risky than other electric utilities. However, he has presented no evidence that this is the case. As I indicated above, independent assessments of DEP's risk indicate a consistent demonstration of lower risk.

Q. HAS MR. HEVERT PRESENTED ANY EVIDENCE THAT THE RISKS OF ELECTRIC UTILITIES IN GENERAL AND DEP IN PARTICULAR HAVE INCREASED IN RECENT YEARS?

A. No, he has not. In fact, the risks of electric utilities and DEP have declined over the past five years. Schedule 1 of Surrebuttal Exhibit DCP-1 compares several independently derived (*i.e.*, Value Line and Moody's) risk indicators for Duke Energy Corporation (DE), DEP, and the two proxy groups (*i.e.*, Parcell and Hevert) discussed in my Direct Testimony. The following averages of the respective risk indicators are:

	Value Line Safety		Value Line Beta		Value Line Financial Str		Moody's Bond Rating	
Group	2014	2019	2014	2019	2014	2019	2014	2019
Parcell	1.80	1.20	0.72	0.54	A	A+	Baa1/Baa2	Baa1
Hevert	2.30	1.80	0.76	0.60	B++	A	Baa1/Baa2	Baa1
DE	2.00	2.00	0.70	0.50	A	A	Baa2	Baa1
DEP							A1	A2

This indicates that both DEP/DE and the two proxy groups have enjoyed improvements in their respective risk assessments since 2014.

IV. DISCOUNTED CASH FLOW MODEL (DCF)

Q. ON PAGES 39-43 OF HIS REBUTTAL TESTIMONY, MR. HEVERT MAINTAINS THAT EXCLUSIVE RELIANCE ON ANALYSTS' FORECASTS OF EARNINGS PER SHARE IS APPROPRIATE IN A DCF CONTEXT. DO YOU HAVE ANY COMMENTS ON THIS?

A. Yes, I do. I first note that I do not criticize him for using analysts' forecasts of EPS as one component of growth in his interpretation of the DCF model. In fact, I use EPS forecasts in my DCF analyses as well. What I criticize him for is the *exclusive* reliance on EPS forecasts. As I indicate in my Direct Testimony, investors have a wealth of information available to use in making investment decisions. It is overly simplistic to believe that all investors rely exclusively on EPS forecasts, yet that is what Mr. Hevert is implicitly assuming.

Q. ON PAGE 39, LINES 14-19, MR. HEVERT MAINTAINS THAT "ANALYSTS' EARNINGS PROJECTIONS ARE THE RELEVANT MEASURE OF GROWTH." DO YOU AGREE?

A. I agree that analysts' projections are "a" relevant measure of growth, but not the "only" relevant measure of growth. If Mr. Hevert were correct, common stock investment would be a very simple exercise and all investors could simply focus on such forecasts in making investment decisions. However, such is not the real world. Different investors have an extensive array of information available to them, only one of which is EPS forecasts. Mr. Hevert paints a very simple picture of a very complex market.

V. CAPITAL ASSET PRICING MODEL (CAPM)

Q. WHAT IS THE FIRST POINT MR. HEVERT ADDRESSES IN HIS REBUTTAL TESTIMONY ON THE CAPM ISSUE?

A. Mr. Hevert states his belief, on pages 58-59 of his Rebuttal Testimony, that my use of 20-year U.S. Treasury bonds is improper for use as the risk-free rate in a CAPM context.

Q. DO YOU HAVE ANY COMMENTS ON HIS POSITION?

A. Yes, I do. As I note in my Direct Testimony, the Duff & Phelps studies, which were used in part to determine my proposed risk premium, use 20-year U.S. Treasury bonds as the measure of "long-term government bonds." Thus, I am consistent in the use of the term of U.S. Treasury bonds. Mr. Hevert is not. Nor does he acknowledge the use of the 20-year term of the Duff & Phelps studies in his Rebuttal Testimony.

Q. ON PAGES 61-62, OF HIS REBUTTAL TESTIMONY, MR. HEVERT MAINTAINS THAT YOUR CAPM ANALYSIS SHOULD HAVE USED FORECASTED YIELDS ON U.S. TREASURY BONDS RATHER THAN THE CURRENT YIELDS YOU USED. WHAT IS YOUR RESPONSE TO HIS ASSERTION?

A. I disagree with Mr. Hevert. As I noted in my Direct Testimony, it is proper to use the current yield as the risk-free rate in a CAPM context. This is the case since the current yield is known and measurable and reflects investors' collective assessment of all capital market conditions. I note that actual yields, not forecasted yields, are used to determine the risk premium; thus, it is consistent to apply the risk premium to actual yields rather than forecasted yields.

Q. DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING MR. HEVERT'S CLAIMS THAT PROJECTED INTEREST RATES SHOULD BE USED AS THE RISK-FREE RATE IN A CAPM CONTEXT?

A. Yes, I do. Mr. Hevert claims on page 62 of his Rebuttal Testimony that it is proper to use interest rate forecasts from "Blue Chip." However, it is apparent that, had he proposed such a use of projected rates in prior cases, he would have been incorrect. The table below shows the historic projection of 30-year U.S. Treasury bonds by Blue Chip, as well as the actual yields.

Date of Blue Chip	Forecast Period	Forecast 30-Year T Bonds	Actual 30-Year T Bonds Yield
Nov. 1, 2009	1 Q 2011	5.00%	4.56%
Nov. 1, 2010	1 Q 2012	4.50%	3.14%
Nov. 1, 2011	1 Q 2013	3.80%	3.28%
Nov. 1, 2012	1 Q 2014	3.40%	3.68%
Nov. 1, 2013	1 Q 2015	4.20%	2.55%
Nov. 1, 2014	1 Q 2016	4.10%	2.72%
Nov. 1, 2015	1 Q 2017	3.80%	3.04%
Nov. 1, 2016	1 Q 2018	3.10%	3.03%

This indicates that in seven of the last eight years, forecasts of 30-Year U.S. Treasury bonds exceeded the actual levels. In some years, the differential was substantial (*e.g.*, 2010 [1.36 percentage points], 2013 [1.65 percentage points], 2014 [1.38 percentage points], and 2015 [0.76 percentage points]). As a result, any witness or Commission who relied upon forecasted interest rates would have over-estimated the cost of equity.

Q. ON PAGES 64-65 OF HIS REBUTTAL TESTIMONY, MR. HEVERT STATES THAT IT IS IMPROPER TO CONSIDER GEOMETRIC MEAN RETURNS IN THE DETERMINATION OF A RISK PREMIUM AND THAT ONLY ARITHMETIC RETURNS ARE APPROPRIATE. DO YOU AGREE WITH THIS POSITION?

A. No, I do not. However, what is most important is not what Mr. Hevert and I believe, but what investors actually rely upon in making investment decisions. It is apparent that investors have access to both types of returns (*i.e.*, arithmetic and geometric) when they make investment decisions.

In fact, it is noteworthy that mutual fund investors regularly receive reports on their own funds, as well as prospective funds they are considering investing in, that show geometric returns. Based on this, I find it difficult to accept Mr. Hevert's position that only arithmetic returns are appropriate.

Q. DOES MR. HEVERT USE VALUE LINE INFORMATION IN HIS COST OF CAPITAL ANALYSES?

A. Yes, he does. He has in fact cited Value Line reports on various electric utilities in his Direct and Rebuttal Testimonies.

Q. DO THE VALUE LINE REPORTS SHOW HISTORIC AND PROSPECTIVE GROWTH RATES FOR THE ELECTRIC UTILITIES?

A. Yes, they do.

Q. DO THESE VALUE LINE REPORTS SHOW HISTORIC AND PROSPECTIVE RETURNS ON AN ARITHMETIC BASIS?

A. No, they do not.

Q. DO THE VALUE LINE REPORTS SHOW HISTORIC AND PROSPECTIVE RETURNS ON A GEOMETRIC, OR COMPOUND GROWTH RATE BASIS?

A. Yes, they do. Surrebuttal Exhibit DCP-1, Schedule 2, describes Value Line's method of calculating growth rates. As a result, any investor reviewing Value Line, as Mr. Hevert does, would be using geometric growth rates.

Q. IS IT YOUR POSITION THAT ONLY GEOMETRIC GROWTH RATES SHOULD BE USED?

A. No. I believe that both arithmetic and geometric growth rates should be used as I have done in my Direct Testimony (see page 39). This is the case because investors have access to both and presumably use both.

Q. ON PAGES 62-63, MR. HEVERT ALSO TAKES ISSUE WITH YOUR USE OF ACHIEVED RATES OF RETURN ON BOOK EQUITY IN DERIVING THE EQUITY RISK PREMIUM IN YOUR CAPM ANALYSIS. WHAT IS YOUR RESPONSE TO THIS?

A. I disagree with Mr. Hevert. As I indicate on pages 38-39 in my Direct Testimony, I used measures of both book returns and market returns in developing my CAPM market risk premium components. The rates (*i.e.*, prices) of public utilities are set based upon the book values of their rate base and capital structures, as well as the book levels of expenses and revenues. As such, it is appropriate to consider the level of return on book equity in the determination of the cost of equity (which is applied to the book level of common equity). I also note that the risk premium I derive from my use of book rates of return is the highest of the three risk premiums I considered in my CAPM analyses.

VI. COMPARABLE EARNINGS (CE) METHOD

Q. ON PAGES 78-80 OF HIS REBUTTAL TESTIMONY, MR. HEVERT INDICATES HIS BELIEF THAT YOUR ASSOCIATION OF MARKET-TO-BOOK RATIOS AND RETURNS ON EQUITY IS SUPPORTED BY NEITHER THE ACADEMIC LITERATURE NOR A HISTORICAL ANALYSIS OF THE EXPERIENCE OF NON-PRICE REGULATED COMPANIES. WHAT IS YOUR RESPONSE TO THIS?

A. I disagree with Mr. Hevert. Clearly, public utilities have their rates regulated (*i.e.*, set) based upon their book value of rate base and capital structure. In fact, the cost of capital is reflected in the fair return on book value of common equity. Investors are aware of this relationship. Any reference to the experience of unregulated companies, as is evident in Mr. Hevert's Rebuttal Testimony, simply misses the point of public utility regulation.

I further note that Mr. Hevert has mis-represented my testimony on the use of market-to-book ratios ("M/B") in CE context. My CE analyses and conclusions are based upon the actual and projected ROE for the proxy group of electric utilities. I make no adjustment, as Mr. Hevert implies, for the M/B. Rather, I use the M/B as a standard to show that while these companies have earned and are expected to earn these ROEs, their stock price has greatly exceeded 100 percent, which means that their stock market value exceeds the book value upon which their rates are established. I note that in the 1970s and early 1980s, when M/B was less than 100 percent, utilities (including DEC from my personal memory) claimed that this was an indication of existing authorized and earned

ROEs being inadequate. They also claimed that they could not issue new shares of common stock without "diluting" the value of existing shares of stock.

Q. ON PAGES 76-77 OF HIS REBUTTAL TESTIMONY, MR. HEVERT STATES THAT THE M/Bs OF THE S&P 500 HAVE BEEN CONSISTENTLY ABOVE 200 PERCENT. IS THIS OBSERVATION RELEVANT FOR PUBLIC UTILITIES?

A. No, it is not. Mr. Hevert's comments apply to the S&P 500, which is predominately made up of unregulated firms. Many unregulated firms, such as energy producing companies and technology-related companies, have book values that do not reflect the actual value of their underlying assets. As a result, the prices they charge their customers are not significantly related to the book value of their assets.

Utilities, in contrast, have their rates established based upon the book values of their assets (*i.e.*, rate base) and liabilities/common equity (*i.e.*, capital structure). As a result, book value is very relevant for public utilities, such as DEP.

I also note that Mr. Hevert is again inconsistent in his Rebuttal Testimony. As noted elsewhere, in criticizing the McKinsey studies, he is eager to claim that their criticisms of analysts' forecasts were "not specific to the utilities industry and therefore data that may not be relevant to the Company" (page 50, lines 6-7). Yet in his own studies he is willing to rely upon an observation of data concerning an unregulated index (*i.e.*, S&P 500) without any regard to whether it is "specific to the utilities industry and therefore data that may not be relevant to the Company."

Q. ON PAGES 81-82 OF HIS REBUTTAL TESTIMONY, MR. HEVERT STATES THAT HE HAS PERFORMED AN ANALYSIS TO DETERMINE THE EXISTENCE OF A DIRECT RELATIONSHIP BETWEEN THE MARKET-TO-BOOK RATIOS OF UNREGULATED COMPANIES AND THEIR EARNED RATES OF RETURN ON BOOK COMMON EQUITY. IS HIS STUDY RELEVANT FOR PUBLIC UTILITIES?

A. No, it is not. As noted above, Mr. Hevert's study applies to the S&P 500, which is predominately made up of unregulated firms. For the same reasons stated in the previous answer, Mr. Hevert's study is not relevant for DEP.

Q. ARE THERE ANY INCONSISTENCIES BETWEEN MR. HEVERT'S CRITICISM OF YOUR REFERENCE TO M/B AND OTHER PARTS OF HIS TESTIMONY?

A. Yes. Recall that Mr. Hevert claims, in his DCF analyses and Rebuttal Testimony, that EPS is the primary consideration in expected growth rates. This is equivalent to saying that EPS is the primary determinant of stock prices. Yet, he is claiming that ROE and M/B are not related. These are inconsistent positions.

ROE is EPS divided by BVPS ("book value per share"). M/B is stock price divided by BVPS. Thus, BVPS is a component in both ratios. Logically, and mathematically, if EPS and stock price are related, then ROE and M/B are related. Thus, if EPS drives stock prices, as Mr. Hevert claims in his DCF analyses, then ROE drives M/B.

VII. OTHER HEVERT ISSUES

Q. HAS MR. HEVERT MADE ANY ADDITIONAL INCORRECT CLAIMS ABOUT OR MISREPRESENTATIONS OF YOUR TESTIMONY?

A. Yes, he has. Mr. Hevert has devoted several pages of his Rebuttal Testimony (pages 28-30) to claims that I propose a reduction in DEP's return on equity due to the extensive suite of regulatory mechanisms that the Company has access to. Whereas it is true that I cite the risk-reducing nature of these mechanisms, it is not true that I propose a reduction in DEP's return on equity to reflect their existence. Clearly, as I state on page 23, lines 23-24 of my Direct Testimony, "I recommend that DEP's return on equity be set at no higher than the mid-point of the cost of equity range for the proxy companies." The fact that DEP has superior credit ratings, relative to the proxy companies (as I show on page 18, lines 6-10) further indicates that my recommendation is not a reduction relative to the more-risky proxy groups.

In addition, on pages 36-38, Mr. Hevert claims that my proxy group is not as appropriate as his proxy group. This is an unwarranted criticism as my cost of equity analyses are applied to *both* my proxy group and his proxy group. The DCF, CAPM, and CE results for both proxy groups are nearly identical.

VIII. RESPONSE TO DEP WITNESS SULLIVAN

Q. DOES MR. SULLIVAN RESPOND TO YOUR USE OF DEP'S COST OF LONG-TERM DEBT?

A. Yes, he does. I note that DEP's Application proposed a cost of long-term debt as of December 31, 2017 of 4.06 percent. I accepted this cost rate in my Direct Testimony. Mr. Sullivan states that my agreement with DEP's proposed December 31, 2017 cost of debt (*i.e.*, 4.06 percent) is "inconsistent with the ORS's proposal to update the cost of debt in Duke Energy Carolinas, LLC's ("DE Carolinas") pending South Carolina rate case to reflect 2018 long-term debt financing activity" (page 3, lines 4-12).

I note that I am not taking inconsistent positions in the DEC and DEP cases. In the DEC case, I indicated on page 27, lines 7-11 of my Direct Testimony that I was updating the Company's cost of long-term debt to reflect the re-financing of certain long-term debt issues that matured during the calendar year following December 31, 2017 (and thus classified as short-term debt or long-term debt maturing within one year). This proposal did not update all of DEC's long-term debt costs. In DEC witness Sullivan's Rebuttal Testimony in that proceeding (see pages 3-4), the Company agreed with the concept of updating its cost of long-term debt but proposed its cost rate as of December 31, 2018. In my Surrebuttal Testimony in the DEC proceeding, I stated on page 17, lines 5-7 that I was not opposed to Mr. Sullivan's proposal to update the cost of long-term debt to December 31, 2018. I am now taking the same position in the DEP proceeding and I accept the Company's cost of long-term debt as of December 31, 2018 of 4.16 percent.

IX. DEP'S CLAIMS ON IMPACT OF ORS PROPOSALS

Q. HAVE MR. HEVERT AND MR. SULLIVAN CRITICIZED THE ORS' DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes. Mr. Hevert states in his Rebuttal Testimony (page 34, lines 2-5):

> Mr. Parcell's recommendation to *further adjust the company's ROE downward* to account for the Company's Commission-approved deferral accounts unnecessarily penalizes the Company and compounds the financial effect of ORS's recommendation on the Company. [emphasis added]

In addition, Mr. Sullivan claims on page 2, line 22 and page 3, lines 1-2 of his Rebuttal Testimony that there are "financial impacts to the Company from the overall revenue requirement recommendation of the ORS."

Q. DO YOU HAVE ANY COMMENTS ABOUT MR. HEVERT'S CLAIM?

A. Yes, I do. Mr. Hevert's claim is categorically false and totally misrepresents what I stated in my Direct Testimony. I clearly state on page 20, lines 21-22 and page 21, lines 1-2:

> Those mechanisms, on both an independent and collective basis, have the effect of *transferring a portion of DEP's risks from its shareholders to its ratepayers*. This is the case since the risk of fully recovering certain expenses is reduced or eliminated. [emphasis added]

This should have been clear to Mr. Hevert that I am talking about the recovery of DEP's expenses (as does ORS witness Zachary Payne), not for an additional recovery of a return on these expenses.

Mr. Hevert further misrepresents my testimony when he states that I have "adjusted" the Company's return on equity downward. Again, I clearly state on page 23, lines 22-24:

> At the very least, the existence of DEP's various existing mechanisms should be recognized in the ROE determination. I recommend that DEP's return on equity be set at no higher than the mid-point of the cost of equity range for the proxy companies.

There is no "adjustment" to my return on equity recommendation. I am clearly stating that DEP's return on equity should be the same as the mid-point of the proxy group's return. Had I incorporated an "adjustment," my proposed return on equity would have been less than 9.3 percent. In addition, I have demonstrated that DEP's superior security ratings, relative to those of the proxy groups, could provide justification for an "adjustment" to the Company's return on equity. However, I have made no such adjustment, contrary to Mr. Hevert's misrepresentation of my testimony.

I further note that the apparent intent of this portion of Mr. Hevert's Rebuttal Testimony is to imply there is an inconsistency between my testimony and ORS witness Payne's testimony. In fact, there is none. My testimony, as cited above, clearly refers to the recovery of expenses (as does ORS witness Payne) and does not address the appropriateness of further adding a return on these expenses. Nor do I propose an "adjustment" to DEP's return on equity, as Mr. Hevert erroneously claims.

Q. DO YOU HAVE ANY RESPONSE TO MR. HEVERT'S CLAIM THAT DEP SHOULD BE ENTITLED TO A "RETURN" ON CERTAIN OF ITS DEFERRED EXPENSES?

A. Yes, I do. It is my understanding that ORS witness Payne is proposing that DEP should receive a "return of" all of its allowable deferred expenses, and only receive a "return on" its deferred capital expenses. Whereas this is an accounting/revenue requirement issue, I concur with ORS witness Payne that there is no requirement that the Company receive a return on its expenditures that are not related to traditional rate base items. It is my understanding, based on more than 40 years of utility rate case experience, that rate base and operating expenses are treated differently, with only rate base items being eligible for a return.

Q. MR. SULLIVAN PROVIDES A TABLE ON PAGE 14 OF HIS SURREBUTTAL TESTIMONY THAT PURPORTS TO SHOW AUTHORIZED RETURNS ON EQUITY FOR "VERTICALLY INTEGRATED ELECTRIC UTILITIES LOCATED IN THE SOUTHEASTERN UNITED STATES." DO YOU HAVE ANY RESPONSE TO THIS TABLE?

A. Yes, I do. Noticeably absent from this table is Virginia Electric and Power in Virginia[5] (which is a Southeastern U.S. state). This company, which is perhaps the most closely-related utility to DEP in terms of size and operations, has a currently-authorized

[5] Mr. Sullivan cites Virginia Electric and Power's ROE in North Carolina (which was a settled ROE) but does not cite the Company's ROE in Virginia (which was a litigated ROE).

return on equity of 9.2 percent.[6] In addition, Georgia Power has had its return on equity for the purposes of its on-going nuclear construction program riders updated to 10.0 percent[7] (which occurred subsequent to its last general rate proceeding), well below the 10.95 percent cited in Mr. Sullivan's table.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

[6] DEP witness Hevert was the cost of capital witness for Virginia Electric and Power Co. in this proceeding.
[7] Value Line Investment Survey, February 17, 2017.

PROXY COMPANIES
RISK INDICATORS

Company	Value Line Safety Rank 2014	Value Line Safety Rank 2019	Value Line Beta 2014	Value Line Beta 2019	Value Line Financial Strength 2014	Value Line Financial Strength 2019	Moody's Bond Rating 2014	Moody's Bond Rating 2019
Parcell Proxy Group								
American Electric Power Co.	3	1	0.70	0.55	B++	A+	Baa2	Baa1
Consolidated Edison Co.	1	1	0.65	0.45	A+	A+	Baa1	Baa1
DTE Energy Co.	2	2	0.80	0.55	B++	B++	Baa2	Baa1
Duke Energy Co.	2	2	0.70	0.50	A	A	Baa2	Baa1
Eversource Energy	2	1	0.75	0.60	B++	A	Baa2	Baa1
NextEra Energy, Inc.	2	1	0.75	0.60	A	A+	Baa1	Baa1
Public Service Enterprise Group	1	1	0.80	0.65	A+	A++	nr	Baa1
WEC Energy Group	1	1	0.65	0.50	A	A+	A3	Baa1
Xcel Energy, Inc.	2	1	0.65	0.50	B++	A+	Baa1	A3
Mean	**1.8**	**1.2**	**0.72**	**0.54**	**A**	**A+**	**Baa1/Baa2**	**Baa1**
Hevert Proxy Group								
ALLETE	2	2	0.75	0.65	A	A	Baa1	A3
Alliant Energy	2	2	0.75	0.60	A	A	Baa1	Baa1
Ameren Corp	3	1	0.80	0.55	B++	A	Baa3	Baa1
American Electric Power Co.	3	1	0.70	0.55	na	A+	Baa2	Baa1
AVANGRID	na	2	na	0.40	na	B++	Baa1	Baa1
Black Hills Corp	3	2	0.90	0.75	B+	A	Baa2	Baa2
CMS Energy Co.	3	2	0.70	0.55	B+	B++	Baa2	Baa1
DTE Energy Co.	2	2	0.80	0.55	B++	B++	Baa2	Baa1
El Paso Electric	2	2	0.65	0.65	B++	B++	Baa2	Baa1
Hawaiian Electric Industries	2	2	0.80	0.60	B++	A	nr	nr
NextEra Energy, Inc.	2	1	0.75	0.60	A	A+	Baa1	Baa1
NorthWestern Corp	3	2	0.70	0.55	B+	B++	nr	A3
OGE Energy	2	2	0.85	0.85	A	A	Baa1	Baa1
Otter Tail Corp	3	2	0.95	0.75	B+	A	nr	Baa2
Pinnacle West Capital	1	1	0.75	0.55	A	A+	Baa2	A3
PNM Resources	3	3	0.95	0.65	B	B+	Baa3	Baa3
Portland General Electric	2	2	0.75	0.60	B++	B++	Baa1	A3
Southern Company	2	2	0.60	0.50	A	A	nr	Baa2
WEC Energy Group	1	1	0.65	0.50	A	A+	A3	Baa1
Xcel Energy, Inc.	2	1	0.65	0.50	B++	A+	Baa1	A3
Mean	**2.3**	**1.8**	**0.76**	**0.60**	**B++**	**A**	**Baa1/Baa2**	**Baa1**

nr - not rated by Moody's this year.

na - not available in Value Line this year.

Sources: Value Line Investment Survey, Standard & Poor's Stock Guide.

HOW TO INVEST IN COMMON STOCKS

A Guide to Using

THE VALUE LINE INVESTMENT SURVEY

GLOSSARY

Aaa Corporate Bond Rate—the average yield on corporate bonds rated Aaa by Moody's Investors Service. Bonds that are rated Aaa are judged to be of the best quality.

Accrual Accounting—a method of matching income and expenses in the period they are actually applicable, regardless of the date of collection or payment.

Adjustable-Rate Mortgage Loans (ARMs) (Bank and Thrift Industries)—mortgage loans on which the interest rate charged by the lender is adjusted in accordance with a stipulated, publicly available cost-of-funds index, such as the yield on one-year Treasury bills. (*See Fixed-Rate Mortgage Loans.*)

After market—the market for replacement parts and accessories for a product or group of products. The Auto Parts (Replacement) Industry participates in the automotive after market.

After-Tax Corporate Profits—*see Corporate Profits.*

AFUDC—*see Allowance for Funds Used During Construction.*

Allowance for Funds Used During Construction (Electric Utility Industries)—a non cash credit to income consisting of equity and debt components. This non cash income results from construction work in progress and is expected to be converted into cash income at a future date.

American Depository Receipts (ADRs)—since most other nations do not allow stock certificates to leave the country, a foreign company will arrange for a trustee (typically a large bank) to issue ADRs (sometimes called American Depositary Shares, or ADSs) representing the actual, or underlying, shares. Each ADR is equivalent to a specified number of shares (the ratio is shown in a footnote on the Value Line page).

American Stock Exchange Composite—a market-capitalization weighted index of the prices of the stocks traded on the American Stock Exchange.

Annual Change D-J Industrials (Investment Companies)—the annual change from year end to year end in the Dow Jones Industrial Average, expressed as a percentage.

Annual Change in Net Asset Value (Investment Companies)—the change in percentage terms of the net asset value per share at the end of any given year from what it was at the end of the preceding year, adjusted for any capital gains distributions made during the year.

Annual Rates of Change (Per Share)—compounded annual rates of change of per-share sales, cash flow, earnings, dividends, and book value (or other industry-specific per-share figures) over the past ten years and five years and estimated over the coming three to five years. All forecasted rates of change are computed from the average figure for the past three-year period to an average for a future three-year period. If data for a three-year base period are not available, a two- or one-year base may be used.

Annual Total Return—the capital gain or loss plus the sum of dividend disbursements expected over the next three to five years, all divided by the recent price and expressed as an average annual rate.

Arbitrage—the simultaneous purchase of an asset in one market and sale of the same asset, or assets equivalent to the asset purchased, in another market. Often referred to as "classical arbitrage," this type of transaction should result in a risk-free profit. Risk Arbitrage refers to transactions in stocks involved in takeover activity.

Arbitrageur—a person or organization that engages in arbitrage activity.

Arithmetic Average—a simple mean. Items to be averaged are added and their sum is divided by the number of items. The result is an arithmetic, or simple, average (or mean).

ARM—*see Adjustable-Rate Mortgage Loans.*